The Real Estate ANALYST

DECEMBER 22 1958

MORTGAGE BULLETIN

Volume XXVII

Number 58

Real Estate Economists, Appraisers and Counselors

MORTGAGE PROSPECTS FOR 1959

ONE of the most momentous years in U. S. financial history is drawing to a close. Into a brief twelve-month span have crowded such major events as the sharpest rise (followed abruptly by the swiftest decline) in bond prices on record, to say nothing of a surging bull market in stocks. What's more, to judge by the evidence, 1959 is likely to be another crucial year for mortgage lenders.

Perhaps the most significant trend now visibly shaping up is a further tightening of the money market. After a brief period of relative stability, lasting for roughly 8 to 10 weeks, yields on fixed-income obligations of every kind show unmistakable signs of continuing the rise which began late last spring. In recent weeks, to illustrate, dealers in commercial paper have raised their rates no fewer than three times, to a current level of 3-3/8% on prime 4- to 6-month notes. Similarly, leading sales finance companies, which sell direct to investors, not long ago hiked rates on their own paper. As for long-term obligations, new corporate issues lately have turned sticky, with a number of recent flotations still available at, or slightly below, original offering prices. Meanwhile, most long-term Government bonds have sagged to within a shade of their 1957-58 lows, and, in a few cases, have broken into low ground.

Naturally, the same forces also have been at work in the mortgage market. Since September, according to the Federal Housing Administration, secondary market prices for immediate delivery of FHA-insured 5-1/4% home loans (with 25-year maturity and 10% downpayment) have declined from 99.1 to 97.3 on a nationwide basis. During the month of November, the agency added, small decreases were reported in all parts of the country except the Northeast, which scored a small gain. In the Middle Atlantic area, on the other hand, a further drop of ½ point occurred. The trend is underscored still more sharply by the Secondary Market Operations of the Federal National Mortgage Association, which, over the years, have come to be regarded as a reliable barometer. During July, when credit was just beginning to tighten, only 824 home loans, valued at $9,300,000, were submitted to FNMA for purchase. In November, by contrast, new offerings spurted to nearly 4,000, valued at well over $40,000,000.

The trend toward tighter money, if anything, is likely to pick up speed.

For one thing, a noteworthy change appears to be taking place in the attitude of the monetary authorities in Washington. Despite one or two half-hearted moves (such as the belated boost in the rediscount rate from 2% to 2½%, and the largely symbolic advance in stock market margin requirements to 90%), the Federal Reserve since early fall has kept largely to the sidelines. However, last week William McChesney Martin, chairman of the Board, decisively shattered the calm.

In a speech before the Executives Club of Chicago -- his first public address in more than six months -- chairman Martin warned that the battle against inflation in this country is "at a crucial point." During a recent trip abroad, he said, he found a mounting distrust of the dollar and a growing feeling of concern over the continued outflow of gold from these shores (in the past year, the U. S. gold stock has fallen by a record-breaking $2.2 billion). As a consequence, he pledged, in one of the strongest statements he has ever issued, the FRB "will do everything in its power to safeguard our currency."

The importance of Mr. Martin's speech cannot be exaggerated. To some knowledgeable observers of the capital market, it signals an imminent shift in FRB policy, from what might be termed passive to active resistance to inflation. Specifically, in their view, it portends an increase in the rediscount rate from the current level of 2½% (at which point it lags well behind the market generally) to 2-3/4% or perhaps to 3%. December, to be sure, is an unlikely month for a move of this kind -- the rediscount rate has not been changed in December since 1930, when it was lowered. Nonetheless, the possibility cannot wholly be ruled out. In any case, a rise in the near future now looms as decidedly probable. The same sources also look for the Fed to put further pressure on commercial banks' free reserves, which, since summer, have averaged around $100,000,000. Indeed, a decisive shift to what is known as negative free -- or "not borrowed" -- reserves, such as prevailed during much of 1957, well may be in the cards.

Other factors, technical and fundamental alike, are pointing in the same direction. For example, owing to the collapse of bond prices earlier this year, commercial banks have accumulated heavy losses in their security portfolios. For tax purposes, however, most banks have chosen to postpone establishing such losses until the turn of the year. After January 1, accordingly, the intermediate and longer-term sectors of the Government bond market may be under considerable pressure from such offerings.

Fundamentally, demand for both long- and short-term credit is virtually certain to increase next year. In this connection, the statistics on business and consumer loans are provocative. After lagging throughout most of 1958, commercial, industrial and agricultural loans in recent weeks have begun to score sizable advances. By the same token, consumer credit, which, for the first time since World War II, failed to show any advance in 1958, is apt to resume its upswing next year. As to long-term obligations, the very high lev-

el of new corporate flotations is not expected to slacken appreciably in 1959. The record volume of new municipals -- an estimated $7.5 billion in 1958 -- well may be exceeded next year.

Tax-exempt securities, incidentally, are growing increasingly attractive to life insurance companies. In 1958, net investments of life companies in State and local issues probably rose to $325 million, compared with less than half this total in 1957. If yields on municipals improve, as seems likely, the insurance companies next year probably will view them with even greater favor. The reason is simple: retroactive to January 1, 1958, the industry soon will be subject to heavier taxation under the terms of a bill now being hammered out by the staff of the House Ways and Means Committee. From $290,000,000 in 1957, Federal income taxes on the industry for 1958 probably will rise to $400-$425 million. True, the increase will stem on the whole from a new levy on underwriting profits, rather than on investment income. Nonetheless, the net effect of the change will be to enhance the value of any source of earnings.

Behind the strong demand for credit, present and prospective, lies the rapid recovery in business activity. In November, the Federal Reserve Board Index of Industrial Production, seasonally adjusted, jumped three points to 141% of the 1947-49 average, two points above the like month a year ago and only six points below the peak of December 1956. What's more, virtually every knowledgeable observer currently looks for a further rise, to new highs, in 1959. According to a survey of 189 manufacturing companies, taken by the National Industrial Conference Board the other day, new orders, dollar billings, production and profits in the first half of next year will run well ahead of depressed year-ago results.

Perhaps the most bullish forecast has come from the Prudential Insurance Co. of America. In the opinion of Prudential, total output of goods and services in 1959 is likely to rise by approximately $34 billion, to nearly $475 billion. Specifically, the institution looks for capital outlays to increase by $2 billion; inventory policy to shift from a $5 billion liquidation to a $2.5 billion accumulation; new home purchases, up $1 billion; Government spending, up $7.5 billion; and consumer buying, up $16 billion. By the way, while too optimistic with respect to the first six months of 1958, Prudential over the years has compiled an enviable record as a forecaster.

Biggest demand of all for funds in 1959 will come from the biggest single borrower, the U. S. Treasury. Next month, according to the best estimates of Government bond dealers, the Treasury will be in the market for approximately $2 billion of new money (terms of the offering, in fact, may be announced prior to New Year's Day). The feeling is growing in the marketplace that the offering will include a long-term bond, the first since last spring. Such expectations naturally have tended to depress existing securities. In addition, the Department faces the problem of refunding the huge amount of short-term borrowings which fall due in 1959.

According to an estimate by the vice president of one Government bond house, next year "probably will be one of the biggest in terms of dollar amounts of maturing obligations to be dealt with that we have ever had to face." Specifically, he points out that on January 1, 1959, nearly $49 billion of the public debt will fall due within twelve months. Moreover, after January, the Treasury will have to raise perhaps another $5 billion in new money. All told, it will be forced to come to market for refunding and borrowing not only in January, but also in February, March, May, June, August, November and December.

So much for the financial picture. In terms of new legislation, the chances are that 1959 also will be a busy year indeed. To begin with, Congress faces an early decision on what to do regarding FHA, which, owing to a remarkable upturn in sales of existing dwellings, soon will exhaust its mortgage insurance authority. As a result, the lawmakers are likely to pass an emergency measure, embodying temporary new authority for FHA.

Such a measure, however, merely would be a stop-gap for the new omnibus bill which is taking shape. While its outlines are not yet clear, presumably it would include most of the provisions contained in a similar measure which failed of passage last year, notably an expanded public housing program, new aid for middle-income and cooperative housing and a revival of the scheme under which FNMA is authorized to buy FHA and VA home loans at par. Despite its obvious socialist bias, the omnibus housing bill of last year came close to garnering the two-thirds vote required (under a special procedure) for enactment: the vote was 251 yeas to 134 nays, just six votes too few. Accordingly, in view of the more "liberal" composition of the 86th Congress, there is a strong possibility that a veto would be overridden.

What ultimately will emerge from Capitol Hill remains to be seen. Perhaps between now and next spring, when the broad housing measure is likely to be under consideration, the plight of the Treasury -- and of the national currency -- will be perceived more clearly on Capitol Hill. If so, fiscal restraint and sound lending precepts yet may prevail. In any case, 1959 plainly will be a year of decision for the home mortgage industry.